

Part III - Administrative, Procedural, and Miscellaneous

Guidance on Withholding and Information Reporting on Foreign Persons, Including Guidance on Certain Book-Entry Systems

Notice 2006-99

SECTION 1. PURPOSE

This notice provides guidance on withholding and information reporting on foreign persons and includes guidance on certain book-entry systems in foreign countries.

This notice provides clarification on whether bonds held through certain book-entry systems are treated as in registered or in bearer form under Treas. Reg. §§5f.103-1(c) and 1.871-14. It concludes that a dematerialized bond that can be held and transferred only through a book entry system is in registered form, when a holder may only obtain a physical certificate in bearer form if the clearing organization that maintains the book entry system goes out of business without a successor. Notwithstanding the clarification set forth in this notice, obligations that are outstanding prior to January 1, 2007, and that were issued in compliance Treas. Reg. §1.163-5(c)(2)(i)(D) (TEFRA D) may continue to be treated as obligations in bearer form until the obligations mature.

Further, this notice announces that the IRS and Treasury intend to issue regulations providing that section 1.871-14(e) of the regulations, dealing with foreign

targeted registered obligations, will not apply to obligations issued after December 31, 2006, except in limited circumstances. The regulations will provide that the rules of section 1.871-14(e) will apply to obligations issued after December 31, 2006, and before January 1, 2009, but only if those obligations have a stated maturity of no more than 10 years from the date of issuance. Obligations issued under the rules of Treas. Reg. §1.871-14(e) prior to January 1, 2009, will continue to be subject to those rules until those obligations mature.

Finally, this notice announces that the IRS and Treasury intend to issue regulations retroactively removing the rule in Treas. Reg. §1.1441-1(b)(7)(iii) that would impose interest under section 6601 when no underlying tax liability has in fact been imposed. These regulations would also clarify that, like interest, penalties that are computed based on underpayments of tax will not be imposed when no tax has in fact been imposed.

SECTION 2. BACKGROUND

.01 Development of dematerialized book-entry systems

IRS and Treasury are aware of the development of dematerialized book-entry systems for holding and transferring bonds. In such systems, bonds are required to be represented only by book entries, and no physical certificates are issued or transferred. Such dematerialized book-entry systems offer significant efficiencies for securities markets, and in order to capture those efficiencies, markets in certain foreign countries have adopted such systems.

For example, Foreign Country law requires that, beginning on a certain date,

bonds issued in that country must be held through the book–entry system operated by Foreign Country Clearing Organization. Foreign Country Clearing Organization is an entity which is in the business of holding obligations for member organizations and transferring obligations among such members by credit or debit to the account of a member without the necessity of physical delivery of the obligation. Within the book-entry system, bonds are not represented by any physical certificates, but are represented only by book entries. Holders do not have the ability to withdraw bonds from the book-entry system and obtain physical certificates representing the bonds. Holders may obtain physical certificates in bearer form only if Foreign Country Clearing Organization goes out of business without a successor that will continue to operate the book-entry system. Bonds that were issued before the book-entry system became mandatory must be transferred into the system by a specified date.

.02 Obligations in registered form

Section 5f.103-1(c)(1) provides that an obligation is in registered form if the obligation is registered as to both principal and interest and the obligation may be transferred only by surrender and re-issuance of the physical certificate or through a book-entry system. Section 5f.103-1(c)(2) provides that an obligation is considered transferable through a book-entry system if the ownership of an interest in the obligation is required to be reflected in a book entry that identifies the owner of an interest in the obligation. Section 5f.103-1(e) provides that an obligation that is not in registered form is considered to be in bearer form. An obligation in registered form that is convertible into bearer form is considered to be in bearer form. Treas. Reg. §1.871-14(c) provides

that for purposes of determining the application of the portfolio interest exception, the conditions for an obligation to be in registered form are identical to the conditions described in Treas. Reg. § 5f.103-1.

SECTION 3. TREATMENT OF OBLIGATIONS HELD THROUGH A DEMATERIALIZED BOOK-ENTRY SYSTEM

.01 Obligations subject to a book-entry requirement described in section 2.01

An obligation subject to a book-entry requirement described in section 2.01 of this notice, and held through the book-entry system operated by Foreign Country Clearing Organization, is an obligation in registered form because, within the book-entry system, it may be transferred only by book entries and the holder of the obligation does not have the ability to withdraw the obligation from the book-entry system and obtain a physical certificate in bearer form.

The cessation of operation of the book-entry system would be an extraordinary event. Holding through the book-entry system is mandatory for obligations in Foreign Country's market while the book-entry system is in existence and while Foreign Country's legal requirements remain in place. The provision for the issuance of physical certificates in bearer form in the event that the book entry system goes out of existence is not the equivalent of a provision conferring on the holder the ability to convert an obligation from registered form into bearer form in the ordinary course of business.

Notwithstanding that such obligations are in registered form, section 3.02 of this notice, below, provides a transition rule for certain obligations issued prior to January 1, 2007.

.02 Obligations issued before January 1, 2007

An obligation in bearer form that was issued before January 1, 2007, and that was issued in compliance with section 1.163-5(c)(2)(i)(D) (TEFRA D) may continue to be treated as an obligation in bearer form until its maturity, whether or not it is held within Foreign Country Clearing Organization's book entry system described in section 2.01 of this notice.

SECTION 4. SUNSET OF FOREIGN TARGETED REGISTERED RULES

The IRS and Treasury intend to issue regulations providing that the rules of section 1.871-14(e) of the regulations, dealing with foreign targeted registered obligations, will not apply to obligations issued after December 31, 2006, except in the limited circumstances described in the next sentence. The regulations will provide that the rules of section 1.871-14(e) will apply to obligations issued after December 31, 2006, and before January 1, 2009, but only if those obligations have a stated maturity of no more than 10 years from the date of issuance. Obligations issued under the rules of Treas. Reg. §1.871-14(e) prior to January 1, 2009, will continue to be subject to those rules until those obligations mature.

SECTION 5. INTEREST IMPOSED WHEN NO TAX DUE

Treas. Reg. §1.1441-1(b)(7)(iii) provides that a withholding agent that has failed to withhold tax other than based on reliance on the appropriate presumptions is not relieved from liability for interest under section 6601. It further provides that such liability exists even when there is no underlying tax that is ultimately shown to be due. That is, the regulation imposes an interest charge under section 6601 on a withholding

agent for an amount of tax that has not in fact been imposed. Treas. Reg. §1.1441-1(b)(7)(v) sets forth two examples that illustrate the operation of this rule.

The IRS and Treasury intend to issue regulations retroactive to January 1, 2001, removing the rule in Treas. Reg. §1.1441-1(b)(7)(iii), and the accompanying examples illustrating the rule in Treas. Reg. §1.1441-1(b)(7)(v), that imposes interest under section 6601 when no underlying tax liability is imposed. Further, the IRS and Treasury intend, in the new regulations, to clarify also that, like interest, penalties that are computed based on underpayments of tax will not be imposed when no tax has in fact been imposed. Taxpayers may rely on this notice until the regulations removing the rule are finalized.

SECTION 6. COMMENTS

Comments are requested regarding the regulations to be issued under Section 4 of this notice. Specifically, comments are requested on the transition period to be provided for such rules.

SECTION 7. CONTACT INFORMATION

The principal author of this notice is Kay Holman of the Office of Associate Chief Counsel (International). For further information regarding this notice contact Kay Holman at (202) 622-3840 (not a toll-free call).